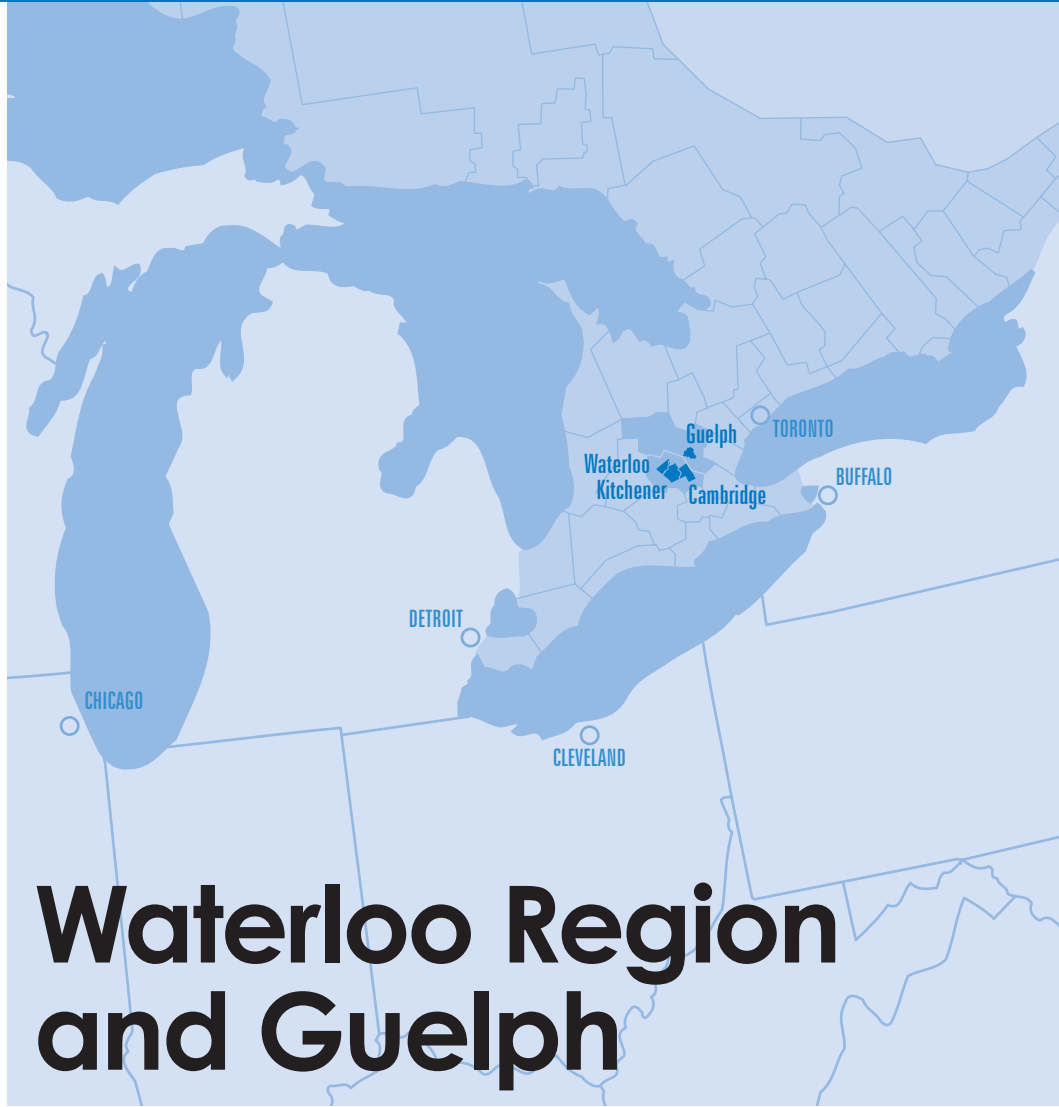
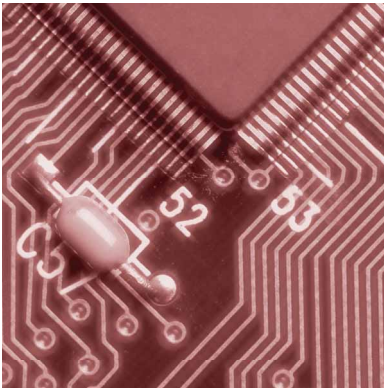
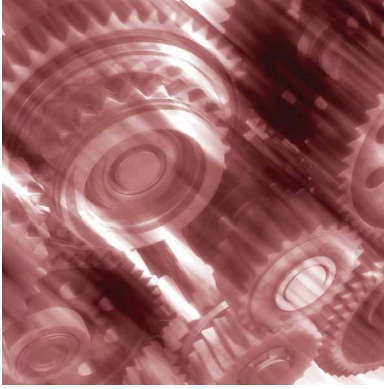




ECONOMIC
RESEARCH



Waterloo Region and Guelph

ECONOMIC UPDATE
JULY 2008

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WATERLOO REGION AND GUELPH: ECONOMIC UPDATE

Overview

The Waterloo Region (which includes Kitchener, Waterloo, and Cambridge) and Guelph have endured a couple of challenging years. The local economy has grappled with the surge in the Canadian dollar, a pronounced drop in U.S. auto demand, and record energy prices. Along with rising competition with China, these forces have all weighed heavily on the Region's manufacturing base. Even so, the area's economy still enjoys solid underpinnings, with unemployment below and incomes above the provincial and national benchmarks.

Given its relatively youthful demographics, its strong educational institutions, and its diversified industrial mix, the area should perform well over the medium term as the broader North American economy turns the corner. Once the current weakness passes, we expect growth in Waterloo-Guelph to exceed both the Ontario and Canadian rates over the 2009-12 period.

2008 First Half in Review

The economy of Waterloo-Guelph grew modestly in the first half of 2008 after a stumble in 2007. We estimate real GDP growth for the Region of about 0.5% this year, in line with last year, but down from 2.0% in 2006.

After falling 0.4% in 2007, employment in the Kitchener CMA managed to rise 1.6% y/y in the first half of 2008. In contrast, employment rose 1.9% in

Ontario in the first half of 2008 and 2.0% in Canada in the same period.

The unemployment rate has bumped up a few notches in the Region since the start of the year, but remains below the Ontario average and is little-changed from last year's trend. In the Kitchener CMA, the jobless rate rose to 5.6% in June versus a first-half average of 5.3%, but is back in line with last year's average 5.6% rate. This compares with the latest unemployment rates of 6.7% in Ontario and 6.2% in Canada.

By industry, employment gains last year were concentrated in the service sector, with employment losses in the goods sector. In the Kitchener CMA, employment in the goods sector fell 5.7%, while employment in the larger service sector rose 2.1%.

Within the goods sector, employment dropped in construction and in manufacturing. Manufacturing, the area's largest sector, has been hit hard by the sharp rise in the Canadian dollar and weakening U.S. demand, particularly for autos.

Plant closures have eroded the area's manufacturing base over the last couple of years, including ABB, American Standard, BF Goodrich, Image Craft, Imperial Tobacco and La-Z-Boy. In addition, a number of other companies continue to operate in the area, but have laid off large numbers of workers,

including Cargill Better Beef, Lear, MTD Products and NCR.

Employment growth in the service sector was led by education, information, culture and recreation, accommodation and food services, and health and social assistance.

After a 31% plunge in housing starts in the Kitchener CMA in 2006, new home construction showed some signs of life in 2007 and continued to recover modestly in the first half of 2008. Housing starts in the Kitchener CMA were up 5.4% over 2006. So far this year, starts are up slightly further

Economic Outlook

| | Waterloo- Guelph | Ontario | Canada |
|-------------------------------|---------------------|---------------|----------------|
| Real GDP (% change) | | | |
| 2005 | 5.5 | 2.9 | 3.1 |
| 2006 | 2.0 | 2.1 | 2.8 |
| 2007 | 0.5 | 2.1 | 2.6 |
| 2008 | 0.5 | 0.2 | 1.0 |
| 2009-12 | 2.7 | 2.3 | 2.5 |
| Employment (% change) | | | |
| 2005 | 4.0 | 1.3 | 1.4 |
| 2006 | 0.9 | 1.5 | 2.0 |
| 2007 | -0.4 | 1.6 | 2.3 |
| 2008 | 1.2 | 1.2 | 1.6 |
| 2009-12 | 1.5 | 0.9 | 1.0 |
| Unemployment rate (%) | | | |
| 2005 | 5.5 | 6.6 | 6.8 |
| 2006 | 5.3 | 6.3 | 6.3 |
| 2007 | 5.6 | 6.4 | 6.0 |
| 2008 | 5.6 | 6.6 | 6.2 |
| 2009-12 | 5.4 | 6.4 | 6.1 |
| Housing starts (units) | | | |
| 2005 | 4,714 | 77,800 | 224,000 |
| 2006 | 3,463 | 74,200 | 228,400 |
| 2007 | 3,681 | 68,100 | 228,100 |
| 2008 | 3,800 | 65,900 | 212,000 |
| 2009-12 | 4,000 | 57,000 | 175,000 |

Figures in **bold italics** are BMO Capital Markets estimates or forecasts.

from the same period in 2007, mirroring the resilient trend seen across Canada. Despite the recent increases, housing starts are running well below the pace of earlier in the decade in the local region.

Investment in non-residential construction in the Kitchener CMA edged up 0.3% in 2007, and was up a further 5.4% y/y in the first half of 2008. Both industrial construction and institutional and governmental construction were up by more than 50% in the first half, but these gains were nearly offset by a 20% drop in commercial construction. By contrast, non-residential building permits have charged ahead by 37% so far this year, led by big gains in commercial projects as well as further strength in institutional and government plans.

Outlook

Through the second half of this year and into 2009, the area's economy will continue to face the challenges of a high Canadian dollar and weak U.S. demand. Nonetheless, the economy should see the start of a turnaround next year, and then enter a period of strong growth by 2010. We expect real GDP growth of 0.5% in 2008, but closer to 2% next year.

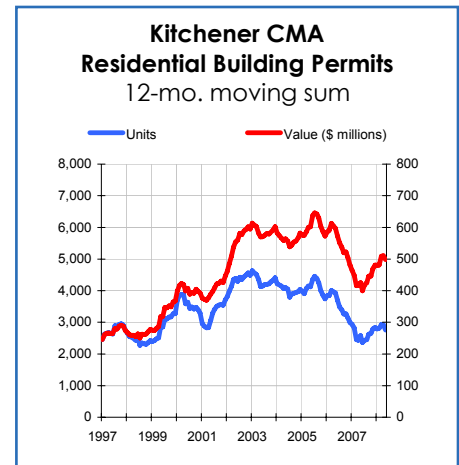
The manufacturing sector will remain under intense pressure as it adjusts to the strong Canadian dollar and copes with weak U.S. demand. Collins & Aikman announced in January 2008 the closure of its auto parts plant in Guelph, with 500 jobs. Also, Engel Canada ceased production in Guelph, affecting 225 jobs. But the

manufacturing sector may eke out a gain in employment in 2008 due to the opening of the new Toyota plant in Woodstock, which will employ 2,000. Although the new plant is not in the Waterloo-Guelph area, it is only 45 km down the road from Cambridge. Many of the workers at the new plant will live in the Waterloo-Guelph area. The new plant will be managed from Cambridge, and Toyota will bring in many workers from its existing plant in Cambridge to work in Woodstock.

Research In Motion will again be a huge source of strength for the area in 2008. With more than 5,000 employees in Waterloo already, the company is adding hundreds of jobs per year at its Waterloo head office and manufacturing facilities.

There are other encouraging signs on the job creation front. Japanese auto parts maker Denso Manufacturing (which supplies to Toyota) is doubling its workforce in Guelph over the next three years to 600. Tim Horton's will ramp up operations at its distribution centre in Guelph, bringing its workforce to about 800 from 425 currently. Google has moved into the University of Waterloo's Research Park, with plans to eventually have 200 employees there, up from about 20 currently. The Province of Ontario's new data centre in Guelph will initially employ 120 when it opens in 2010, with plans for double that in phase two.

While employment fell in the Kitchener CMA in 2007 on an annual average basis, the more recent

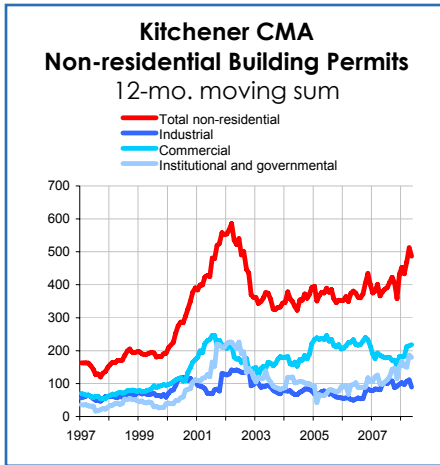


monthly numbers are more encouraging so far in 2008. After hitting a recent low in June 2007, employment has since risen 2.9%. Similarly, after peaking at 5.9% in February 2007, the unemployment rate dropped to 5.6% by June 2008.

In the Kitchener CMA, residential building permits were up 8.6% from year-ago levels in the first five months of 2008. We expect starts to rise slightly to about 2,800 in 2008 from 2,740 in 2007.

Our expectation of higher housing starts in Waterloo-Guelph area is contrary to the national outlook. Nationally, we expect housing starts to decline from 228,100 in 2007 to 212,000 in 2008.

The difference between the local and national outlook arises because local housing starts are currently running well below their peaks earlier in the decade, while the recent trend in national starts was still close to its peak.



In **Kitchener**, the University of Waterloo's School of Pharmacy building will open this year, and construction will start this year on a new medical school. Both are part of the University of Waterloo's new Health Sciences Campus in downtown Kitchener. A new recreation centre with twin ice pads, boxing facilities and indoor walking track opened this year. Fairview Park Mall recently received a \$33 million makeover. St. Mary's General Hospital will complete a 115,000 square foot addition this year, part of a multi-year \$90 million renovation and expansion program. Grand River Hospital will renovate its intensive care unit and construct a new mental health unit, starting this year. The City of Kitchener is spending \$46 million to convert the former BF Goodrich plant into its new central maintenance facility. It is hoped that work will begin this year on the \$90 million Centre Block redevelopment. This project would include two residential towers, public parking and retail shops. Also, there is a \$100 million proposal to redevelop the former Sportsworld site, with offices and small retail shops. After

abandoning plans to build a new main public library after its estimated cost skyrocketed from \$33 million to \$65 million, the City of Kitchener is now considering renovating and expanding its existing main library.

In **Waterloo**, Conestoga Mall is undergoing a \$50 million renovation and expansion. Construction will begin this year on the Balsillie School of International Affairs in downtown Waterloo. Two new buildings are being built at the University of Waterloo's Research Park: the \$8 million first phase of the Research Accelerator Centre and the \$20 million InnoTECH building. The University of Waterloo's School of Optometry is getting an addition to be completed in 2009. There are also a number of other building projects at the University of Waterloo. Future projects include a \$25 million joint city/YMCA library and recreation centre. A proposal has been made to redevelop the Canbar site — a \$200-to-\$250 million project including a 280-room hotel, apartment and condo towers, and office and retail space. Preliminary discussions are taking place about a possible new law school in downtown Waterloo.

Outside of the major cities, the largest project is a \$29 million arena and recreation centre in Elmira, which is to be completed in 2009. A \$200 million gas-fired power plant in Waterloo Region southeast of Cambridge has been proposed.

Municipalities within the region are rushing to make more industrial land available. In Guelph, the first phases of the city's Hanlon Creek Business

Park, which will eventually have more than 350 acres of serviced land, will be available later this year. In Cambridge, the city plans to start bringing the Boxwood subdivision in the Cambridge Business Park to market in 2008, with 150 to 170 acres of developable land. In Kitchener, an additional 30 acres will be available at the Huron Business Park in late 2008. Meanwhile, in Waterloo, there are no city-owned industrial lands available as the city conducts a strategic review.

Also encouraging is the fact that recently vacated industrial properties are being snapped up for redevelopment. Computer distributor Synnex Canada moved into the former Imperial Tobacco facility in Guelph. The City of Kitchener is redeveloping the former BF Goodrich site into a new central maintenance facility. The former NCR plant in Waterloo and Image Craft plant in Cambridge are being redeveloped into industrial/office space. Plans are proceeding to convert the former American Standard building into condominiums. In addition, properties which were sitting idle for longer periods are now being redeveloped into condos, such as the former Arrow shirt factory in Kitchener, the former Tiger Brands knitting factory in Cambridge, and the former Bauer Industries plant in Waterloo. There are also plans in the making to redevelop the former Canbar (Canada Barrel) property in Waterloo into mixed use (hotel, residential, office, retail) and the former Lafarge property in Guelph into commercial space.

Medium-term outlook

Once the area gets past the current economic turbulence, the medium-term outlook for Waterloo-Guelph is positive. We expect the economy to grow at an average annual rate of 2.7% over the 2009-2012 period — slightly faster than both Ontario and Canada. **Five factors** contribute to this positive outlook.

First, we believe that appreciation of the Canadian dollar has largely run its course. The Canadian dollar is now around parity and we expect it to drift down slightly below that level over the next year. Manufacturers will be able to focus on improving efficiency without increases in the value of the loonie wiping out those competitive gains.

Second, the U.S. economy will eventually recover from its current difficulties, which will improve markets for the area's exports over the medium term.

Third, the area has a relatively youthful population and strong net immigration. The population of the area is expected to continue to grow faster than both Ontario and Canada over the medium term. This, in turn, will support residential construction and retail sales.

Fourth, the excellent educational institutions in the area are a source of strength. The University of Guelph, the University of Waterloo, Wilfrid Laurier University and Conestoga College are all top-ranked institutions in Canada and, in some fields, the world. All have strong connections to the business community through their co-operative

education programs. Further, these educational institutions have been good incubators for new companies through their research programs.

Fifth, the area's industrial mix positions it for growth. The advanced manufacturing, information and communications technology (including computer and electronic equipment), and biotech clusters, in particular, have strong growth prospects.

The government of Ontario has targeted advanced manufacturing, in which the Waterloo-Guelph area has particular strength, as a priority with its \$500 million Advanced Manufacturing Investment Strategy. Aircraft landing gear maker Héroux-Devtek, in Kitchener, was a recent recipient of funding under this program.

The main risks to the medium-term outlook relate to exports. An unexpected further strengthening of the Canadian dollar or longer-than-anticipated slump in the U.S. economy would adversely affect the area's manufacturing exports.

The auto industry continues to be a major risk factor for the area. The stronger Canadian dollar and lower labour costs in the U.S. (as a result of the recent agreement between the United Auto Workers and the Big Three auto makers) have eroded some of Canada's cost advantage. On the other hand, the strength of Toyota, which has an assembly plant in the area and, soon, another nearby, is a positive for the region.

The main challenges facing Waterloo-Guelph over the medium

term include the adjustment to the stronger Canadian dollar, increased competition from low-cost countries like China, and the challenge of keeping more of its university and college graduates in the area. Though we believe that the appreciation of the loonie has largely run its course, the adjustment to a new higher level will take time and more manufacturing jobs will be lost. However, the area has demonstrated its ability to absorb these shocks in the past by moving up the value chain. Despite cyclical ups and downs, manufacturing employment in the area has changed little in the past twenty years. Yet the area put in a solid overall economic performance over that period. The recent story of plant closings is really one that has been going on for decades, as old factories close and new ones start up.

With such strong educational institutions in the area, many graduates are lured away by large companies like Microsoft. In this regard, it is encouraging to see locally-based companies like Research In Motion expanding rapidly, and other companies like Google setting up shop in the area.

Longer-term outlook

The Province of Ontario recently passed the Places to Grow Act, which provides a legal framework for growth planning in Ontario. A *Growth Plan for the Greater Golden Horseshoe* was released in 2006. Waterloo-Guelph is part of what is called the outer ring of the Greater Golden Horseshoe. There is limited room for growth in the inner ring of the Greater Golden Horseshoe.

Surrounding the inner ring is a greenbelt, which the province plans to maintain with limited development. Therefore, growth in the Greater Golden Horseshoe will leapfrog the greenbelt over the next twenty-five years into the outer ring.

As development leapfrogs the greenbelt, the population of Waterloo-Guelph will expand rapidly. The population of the Greater Golden Horseshoe is projected to rise 48% between 2001 and 2031, from 7.8 million to 11.5 million. The population of Waterloo Region is projected to rise 60% from 456,000 in 2001 to 729,000 in 2031. The population of Wellington County, including the City of Guelph,¹ is projected to rise 65% from 195,000 to 321,000.

As the area expands, major transportation projects are already in the planning stages. A new Highway 7 between Kitchener-Waterloo and Guelph is being planned, at a cost of \$300-400 million. Construction could start as early as 2011. Also, Waterloo Region is considering a rapid transit rail line. The first phase, at a cost of over \$300 million, would run from Waterloo to Kitchener. A second phase would continue to Cambridge.

Conclusion

Waterloo-Guelph has developed a reputation for innovation. Its entrepreneurial spirit has allowed it to reinvent itself over the years. Old companies close their doors, but new ones are continually opening up. Waterloo-Guelph is leading the charge from the old economy based on traditional manufacturing to the new economy based on high technology and services.

¹ The City of Guelph is not part of Wellington County, but the City of Guelph is geographically surrounded by Wellington County. In the population projections, Wellington County and the City of Guelph are combined into one unit. The Guelph CMA consists of the Township of Guelph/Eramosa, which is part of Wellington County, and the City of Guelph, which is not. In the 2006 census, the Guelph CMA accounted for 63% of the population of the combined Wellington County and the City of Guelph.